

CONSOLIDATED FINANCIAL STATEMENTS

DEPARTMENT OF VETERANS AFFAIRS CONSOLIDATED BALANCE SHEETS (DOLLARS IN MILLIONS)

AS OF SEPTEMBER 30,

	2002	2001
ASSETS		
INTRAGOVERNMENTAL		
Fund Balance with Treasury (Note 3)	\$ 15,076	\$ 13,763
Investments (Note 5)	14,135	14,298
Accounts Receivable, Net (Note 6)	114	65
Other Assets	95	100
TOTAL INTRAGOVERNMENTAL ASSETS	29,420	28,226
PUBLIC		
Investments (Note 5)	214	205
Accounts Receivable, Net (Note 6)	1,199	1,276
Loans Receivable, Net (Note 7)	4,541	4,937
Cash (Note 4)	40	48
Inventories (Note 8)	82	94
General Property, Plant and Equipment (Note 9)	11,028	11,677
Other Assets	28	30
TOTAL PUBLIC ASSETS	17,132	18,267
TOTAL ASSETS	\$ 46,552	\$ 46,493
LIABILITIES		
INTRAGOVERNMENTAL		
Accounts Payable	\$ 74	\$ 77
Debt	3,026	1,917
Other Liabilities (Note 13)	2,016	2,889
TOTAL INTRAGOVERNMENTAL LIABILITIES	5,116	4,883
PUBLIC		
Accounts Payable	2,564	2,380
Liabilities for Loan Guarantees (Note 7)	5,662	5,310
Federal Employee and Veterans Benefits Liability (Note 11)	850,963	693,713
Environmental and Disposal Liabilities (Note 12)	271	260
Insurance Liabilities (Note 15)	12,870	13,064
Other Liabilities (Note 13)	6,090	5,818
TOTAL PUBLIC LIABILITIES	878,420	720,545
TOTAL LIABILITIES	883,536	725,428
NET POSITION		
Unexpended Appropriations	3,366	4,115
Cumulative Results of Operations	(840,350)	(683,050)
TOTAL NET POSITION	(836,984)	(678,935)
TOTAL LIABILITIES AND NET POSITION	\$ 46,552	\$ 46,493

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENTS OF NET COST (DOLLARS IN MILLIONS)

YEAR ENDED SEPTEMBER 30,	2002	2001
NET PROGRAM COSTS (NOTE 18)		
Medical Care	\$ 21,963	\$ 20,129
Medical Education	1,019	778
Medical Research	807	730
Compensation	22,893	20,799
Pension	3,225	3,234
Education	1,317	1,026
Vocational Rehabilitation and Employment	504	543
Loan Guaranty	160	(232)
Insurance	66	54
Burial	402	258
NET PROGRAM COSTS BEFORE CHANGES IN VETERANS		
BENEFITS ACTUARIAL LIABILITIES	52,356	47,319
Compensation	156,700	139,400
Burial	600	-
SUBTOTAL	157,300	139,400
NET NON-PROGRAM COSTS	659	542
NET COST OF OPERATIONS (NOTE 18)	\$ 210,315	\$ 187,261

The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
YEAR ENDED SEPTEMBER 30, 2002
(DOLLARS IN MILLIONS)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ (683,050)	\$ 4,115
Cumulative Effect of Changes in Accounting Principles (Note 22)	(618)	-
Subtotal	(683,668)	4,115
Budgetary Financing Sources		
Appropriations Received	-	52,931
Other Adjustments	-	(113)
Appropriations Used	53,567	(53,567)
Nonexchange Revenue	2	-
Donations	33	-
Other Financing Sources		
Donations of Property	15	-
Transfers-out	(909)	-
Imputed Financing	925	-
Other	-	-
Total Financing Sources	53,633	(749)
Net Cost of Operations	(210,315)	-
Ending Balances	\$ (840,350)	\$ 3,366

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
YEAR ENDED SEPTEMBER 30, 2001
(DOLLARS IN MILLIONS)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ (543,126)	\$ 4,132
Cumulative Effect of Changes in Accounting Principles (Note 22)	-	-
Subtotal	(543,126)	4,132
Budgetary Financing Sources		
Appropriations Received	-	48,882
Other Adjustments	-	(196)
Appropriations Used	48,703	(48,703)
Nonexchange Revenue	5	-
Donations	31	-
Other Financing Sources		
Donations of Property	14	-
Transfers-out	(1,593)	-
Imputed Financing	862	-
Other	(685)	-
Total Financing Sources	47,337	(17)
Net Cost of Operations	(187,261)	-
Ending Balances	\$ (683,050)	\$ 4,115

The accompanying Notes are an integral part of these financial statements.

**DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 19)
YEAR ENDED SEPTEMBER 30, 2002**

(DOLLARS IN MILLIONS)

Budgetary Resources

	Budgetary	Credit Financing
Budget Authority	\$ 55,254	\$ 3,750
Unobligated Balance at the Beginning of the Period	15,481	4,678
Net Transfers-Prior Year Balance	(66)	-
Spending Authority from Offsetting Collections	4,130	5,641
Adjustments	(349)	(2,642)
Total Budgetary Resources	\$ 74,450	\$ 11,427

Status of Budgetary Resources

Obligations Incurred	\$ 58,871	\$ 6,111
Unobligated Balance Available	13,119	-
Unobligated Balance Not Yet Available	2,460	5,316
Total Status of Budgetary Resources	\$ 74,450	\$ 11,427

Outlays

Obligations Incurred	\$ 58,871	\$ 6,111
Less Spending Authority from Offsetting Collections and Adjustments	(4,130)	(5,641)
Obligated Balance, Net Beginning of Period	7,354	114
Less Obligated Balance, Net End of Period	(7,819)	(103)

Outlays

Less Offsetting Receipts	(2,226)	-
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Net Outlays

\$ 52,050	\$ 481
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**DEPARTMENT OF VETERANS AFFAIRS
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 19)
YEAR ENDED SEPTEMBER 30, 2001**

(DOLLARS IN MILLIONS)

Budgetary Resources

	Budgetary	Credit Financing
Budget Authority	\$ 49,647	\$ 1,665
Unobligated Balance at the Beginning of the Period	16,096	5,408
Net Transfers-Prior Year Balance	(244)	-
Spending Authority from Offsetting Collections	3,675	5,253
Adjustments	(195)	(1,564)
Total Budgetary Resources	\$ 68,979	\$ 10,762

Status of Budgetary Resources

Obligations Incurred	\$ 53,379	\$ 6,083
Unobligated Balance Available	13,037	-
Unobligated Balance Not Yet Available	2,563	4,679
Total Status of Budgetary Resources	\$ 68,979	\$ 10,762

Outlays

Obligations Incurred	\$ 53,379	\$ 6,083
Less Spending Authority from Offsetting Collections and Adjustments	(3,675)	(5,253)
Obligated Balance, Net Beginning of Period	5,370	32
Less Obligated Balance, Net End of Period	(7,354)	(114)

Outlays

Less Offsetting Receipts	(1,864)	-
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Net Outlays

\$ 45,856	\$ 748
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The accompanying Notes are an integral part of these financial statements.

DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED STATEMENTS OF FINANCING (NOTE 20)

YEAR ENDED SEPTEMBER 30,

2002

2001

(DOLLARS IN MILLIONS)

Resources Used to Finance Activities

Obligations Incurred	\$ 64,982	\$ 59,462
Less Spending Authority from Offsetting Collections and Adjustments	(9,771)	(8,928)
Obligations Net of Offsetting Collections and Adjustments	55,211	50,534
Less Offsetting Receipts	(2,226)	(1,864)
Net Obligations	52,985	48,670
Donations of Property	15	14
Transfers-out	(847)	(1,593)
Imputed Financing	925	862
Other Financing Sources	(11)	-
Total Resources Used to Finance Activities	53,067	47,953

Resources That Do Not Fund Net Cost of Operations

Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	(38)	277
Resources that Finance the Acquisition of Assets	(7,078)	(7,403)
Resources that Fund Expenses Recognized in Prior Periods	(873)	(238)
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations	5,829	5,585
Other	2	-
Total Resources That Do Not Fund Net Costs of Operations	(2,158)	(1,779)
Total Resources Used to Finance the Net Cost of Operations	50,909	46,174

Costs That Do Not Require Resources in the Current Period

Increase in Annual Leave Liability	48	58
Increase in Environmental and Disposal Liability	12	20
Reestimates of Credit Subsidy Expense	793	937
Increase in Exchange Revenue Receivable from the Public	8	(2)
Increase in Veterans Benefits Actuarial Liability	157,300	139,400
Depreciation and Amortization	809	473
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	89	164
Loss on Disposition of Assets	89	111
Other	258	(74)
Total Costs That Do Not Require Resources in the Current Period	159,406	141,087

Net Cost of Operations

\$ 210,315 \$ 187,261

The accompanying Notes are an integral part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2002 AND 2001
(DOLLARS IN MILLIONS)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Department of Veterans Affairs' (VA) consolidated financial statements report all activities of VA components, including the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA) and staff organizations. The consolidated financial statements meet the requirements of the Chief Financial Officers (CFO) Act of 1990 and the Government Management Reform Act (GMRA) of 1994. The consolidated financial statements differ from the financial reports used to monitor and control budgetary resources, but are prepared from the same books and records. The statements should be read with the understanding that VA is a component unit of the U.S. Government. VA fiscal year (FY) 2002 and FY 2001 financial statements are presented in conformity with the Office of Management and Budget's (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," as amended.

Reporting Entity

The mission of VA is to provide medical care, benefits, social support, and lasting memorials to veterans, their dependents, and beneficiaries [(38 U.S.C. Section 301(b) 1997)].

The Department is organized under the Secretary of VA. The Secretary's office includes a Deputy Secretary and has direct lines of authority over the Under Secretary for Health (VHA), the Under Secretary for Benefits (VBA), and the Under Secretary for Memorial Affairs (NCA). Additionally, six Assistant Secretaries, an Inspector General, a General Counsel, and the chairmen of

the Board of Contract Appeals and the Board of Veterans' Appeals support the Secretary.

Budgets and Budgetary Accounting

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources, and facilitates compliance with legal constraints and controls over the use of Federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of the purchase. Assets and liabilities that do not consume budgetary resources are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

Basis of Accounting

The accompanying consolidated financial statements have been prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) standards and related concepts. The American Institute of Certified Public Accountants (AICPA) designated FASAB as the accounting standard-setting body for Federal governmental entities. As a result, accounting principles promulgated by FASAB are considered accounting principles generally accepted of the United States of America (GAAP) for Federal governmental entities.

Revenues and Other Financing Sources

Exchange revenues are recognized when earned to the extent the revenue is payable to VA from other Federal agencies or the public as a result of costs incurred or services performed on their

behalf. Revenue is recognized at the point the service is rendered. Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by Treasury's Judgment Fund and post-retirement benefits for VA employees. Non-exchange revenue, e.g., donations, are recognized when received, and related receivables are recognized when measurable and legally collectible, as are refunds and related offsets.

Accounting for Intragovernmental Activities

VA, as a department of the Federal Government, interacts with and is dependent upon the financial activities of the Federal Government as a whole. Therefore, these consolidated financial statements do not reflect the results of all financial decisions applicable to VA as though the department was a stand-alone entity.

In order to prepare reliable financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements.

Fund Balance with Treasury

The Department of the Treasury (Treasury) performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury represents the right of VA to draw on the Treasury for allowable expenditures. Trust fund balances consist primarily of amounts related to the Post-Vietnam Educational Assistance Trust Fund, the National Service Life Insurance (NSLI) Fund, the United States Government Life Insurance (USGLI) Fund, the Veterans Special Life Insurance (VSLI) Fund, General Post Fund, and the National Cemetery Gift Fund. The use of these funds is restricted.

Cash

Cash consists of Canteen Service and Loan Guaranty Program amounts held in commercial banks as well as Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Amounts relating to

the Loan Guaranty Program represent deposits with trustees for offsets against loan loss claims related to sold loan portfolios.

Investments

Investments are reported at cost and are redeemable at any time for their original purchase price. Insurance program investments, which comprise most of VA's investments, are in non-marketable Treasury special bonds and certificates. Interest rates for Treasury special securities are based on average market yields for comparable Treasury issues. Special bonds, which mature during various years through the year 2017, are generally held to maturity unless needed to finance insurance claims and dividends. Other investments from VA programs are in securities issued by Treasury, with the exception of Insurance Program holdings in stock received from Prudential as a result of its demutualization and the Loan Guaranty Program investments, which are in trust certificates issued by the American Housing Trusts, private entities not associated with the Government.

Allowances are recorded to reflect estimated losses of principal as a result of the subordinated position in American Housing Trust certificates I through V. The estimated allowance computations are based upon discounted cash flow analysis. Although VA continues to use the income from these subordinated certificates to cover the immediate cash requirements of the Federal guarantee on loans sold under American Housing Trust certificates VI through XI and the Veterans Mortgage Trust program, the income is reimbursed to VA and is not used to pay the amount of the realized losses on guaranteed loan sales.

Accounts Receivable

Accounts Receivable, Intragovernmental consists of amounts due from other agencies. No allowances for losses are required.

Public Accounts Receivable consists mainly of amounts due from patients and third-party insurers for veterans' health care and amounts due from individuals for compensation, pension, and readjustment benefit overpayments. Based on

prior experience, allowances for bad debt losses have been established at approximately 16 and 19 percent for medical-related receivables, 45 and 50 percent for educational-related receivables, and 74 and 76 percent for compensation and pension benefit overpayment-related receivables for FY 2002 and 2001, respectively.

VA is required by Public Law 96-466 to charge interest and administrative costs on benefits debts similar to charges levied on other debts owed the Federal Government. In a July 1992 decision, the former VA Deputy Secretary decided that VA would not charge interest on compensation and pension debts. This decision continues to be VA policy.

Loans Receivable

Loans Receivable are recorded as funds are disbursed. For loans obligated prior to October 1, 1991, loan principal and interest receivable amounts are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience and an analysis of outstanding balances. For loans obligated after September 30, 1991, an allowance equal to the subsidy costs associated with these loans reduces the loans receivable. This reduction is due to the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows.

Inventories

Inventories consist of items such as precious metals held for sale and Canteen Service retail store stock and are valued at cost, utilizing the First In First Out (FIFO) method. VA follows the purchase method of accounting for operating, medical, and pharmaceutical supplies in the hands of end users, which provides that these items be expensed when purchased. VA defines an end user as a VA medical center, regional office, or cemetery.

Property, Plant, and Equipment

The majority of the general property, plant, and equipment is used to provide medical care to veterans and is valued at cost, including transfers

from other Federal agencies. Major additions, replacements, and alterations are capitalized, whereas routine maintenance is expensed when incurred. Construction costs are capitalized as Construction in Progress until completion, and then transferred to the appropriate property account. Individual items are capitalized if the useful life is 2 years or more and the unit price is \$100,000 or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is also depreciated on a straight-line basis over its useful life, usually 5 to 20 years. There are no restrictions on the use or convertibility of general property, plant, and equipment. All VA heritage assets are multi-use facilities and are classified as general property, plant, and equipment.

Other Assets

Other assets consist of advance payments. Public advance payments are primarily to hospitals and medical schools under house staff contracts, grantees, beneficiaries, and employees on official travel. Intragovernmental advance payments are primarily to the General Services Administration (GSA) for rent and Government Printing Office (GPO) for supplies, printing, and equipment.

Accounts Payable

Accounts Payable, Intragovernmental consists of amounts owed to other Federal agencies. The remaining accounts payable consist of amounts due to the public.

Loan Guarantees

For direct loan obligations and loan guaranty commitments made after 1991, the resulting direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. The present value of the subsidy costs associated with direct loans and loan guarantees is recognized as a cost in the year the direct or guaranteed loan is disbursed. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimated will most

likely require a future cash outflow to pay defaulted claims. Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The guaranteed loan sales liability represents the present value of the estimated cash flows to be paid by VA as a result of the guarantee. VA guarantees that the principal and interest payment due on a loan will be paid by the 15th of each month. If the payment is not made, VA allows the loan servicer to receive funds from a cash reserve account for the amount of the deficiency. VA guarantees the loans against losses at foreclosure. Although VA will not buy back the loan, VA will pay the loan loss and foreclosure expenses.

Debt

All Intragovernmental debt is due to Treasury and is primarily related to borrowing by the Loan Guaranty Program. The interest rates ranged from 4.42 to 5.22 percent in FY 2002 and from 4.52 to 5.75 percent in FY 2001. VA's financial activities interact with and are dependent upon those of the Federal Government as a whole.

Insurance Liabilities

Actuarial reserve liabilities for VA's insurance programs are based on mortality and interest rate assumptions at the time of issue. These assumptions vary by fund, type of policy and type of benefit. The interest rate assumptions range from 2.25 to 5.0 percent for both the FY 2002 and 2001 calculations.

Annual Leave

The accrued annual leave balance is adjusted at the end of the fiscal year to reflect current pay rates for leave that has been earned but not taken. Sick and other types of non-vested leave are expensed as taken. To the extent appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources.

Workers' Compensation Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost

protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. Claims incurred for benefits for VA employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by VA.

Workers' compensation is comprised of two components: (1) the accrued liability which represents money owed by VA to DOL for claims paid by DOL on behalf of VA through the current fiscal year, and (2) the actuarial liability for compensation cases to be paid beyond the current year.

Future workers' compensation estimates are generated from an application of actuarial procedures developed by DOL to estimate the liability for FECA benefits. The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases and for potential cases related to injuries incurred but not reported. The liability is determined by utilizing historical benefit payment patterns related to a particular period to estimate the ultimate payments related to that period.

Pension, Other Retirement Benefits, and Other Post-Employment Benefits

Each employing Federal agency is required to recognize its share of the cost and imputed financing of providing pension and post-retirement health benefits and life insurance to its employees. Factors used in the calculation of these pensions and post-retirement health and life insurance benefit expenses are provided by the Office of Personnel Management (OPM) to each agency.

VA's employees are covered under the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) to which VA makes contributions according to plan requirements. CSRS and FERS are multi-employer plans. VA does not maintain or report information about the assets

of the plans, nor does it report actuarial data for the accumulated plan benefits; that reporting is the responsibility of OPM.

Veterans Benefits Liability

VA provides compensation benefits to veterans who die or are disabled from military service-connected causes as well as to their dependents. These benefits are provided in recognition of a veteran's military service. The liability for future compensation payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Various assumptions in the actuarial model, such as the number of veterans and dependents receiving payments, discount rates, cost of living adjustments and life expectancy, impact the amount of the liability.

Litigation

VA is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of VA management and legal counsel, the ultimate resolutions of these proceedings, actions, and claims, will not materially affect the financial position or results of VA operations.

Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

2. NON-ENTITY ASSETS

Entity and Non-Entity assets have been combined on the face of the balance sheet. Non-Entity assets relate primarily to patient funds.

Non-Entity Assets as of September 30,

	2002	2001
Fund Balance with Treasury	\$ 42	\$ 42
Intragovernmental Accounts Receivable	1	1
Public Accounts Receivable	19	19
TOTAL NON-ENTITY ASSETS	\$ 62	\$ 62

3. FUND BALANCE WITH TREASURY

Fund Balance with Treasury as of September 30,

	2002	2001
Entity Assets		
Trust Funds	\$ 107	\$ 92
Revolving Funds	6,054	5,276
Appropriated Funds	8,780	8,273
Special Funds	105	63
Other Fund Types	(12)	17
TOTAL ENTITY ASSETS	15,034	13,721

Non-Entity Assets		
Other Fund Types	42	42
TOTAL NON-ENTITY ASSETS	42	42
Total Entity and Non-Entity Assets	\$ 15,076	\$ 13,763
Reconciliation of VA General Ledger Balances with Treasury		
Entity VA General Ledger	\$ 15,114	\$ 13,692
Reconciled Differences	(42)	82
Unreconciled Differences	4	(11)
FUND BALANCE WITH TREASURY	\$ 15,076	\$ 13,763
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	\$ 1,540	\$ 1,270
Unavailable	5,584	4,965
Obligated Balance not yet Disbursed	7,922	7,468
Deposit/Clearing Account Balances	30	60
FUND BALANCE WITH TREASURY	\$ 15,076	\$ 13,763

4. CASH

Cash as of September 30,	2002	2001
Canteen Service	\$ 1	\$ 1
Agent Cashier Advance	4	4
Loan Guaranty Program	35	43
Total Cash	\$ 40	\$ 48

5. INVESTMENTS

Investment Securities as of September 30,	2002	2001
Intragovernmental Securities		
Interest Range		
Special Bonds	\$ 13,816	\$ 13,956
Treasury Notes *	74	32
Treasury Bills	2	57
Subtotal	13,892	14,045
Accrued Interest	243	253
Total Intragovernmental Securities	\$ 14,135	\$ 14,298
Other Securities		
Prudential Stock (Insurance)	\$ 11	\$ -
Trust Certificates (Loan Guaranty)	203	205
Total Other Securities	\$ 214	\$ 205

*The investment in Treasury Notes includes unamortized premiums of \$0.7 million as of September 30, 2002 and \$0.2 million as of September 30, 2001. Premiums and discounts are amortized on a straight-line basis over the life of the investments.

**Offset for Losses on Investments
as of September 30,**

	2002	2001
Investment in Subordinate Certificates at Time of Sale	\$ 424	\$ 424
Cumulative Reductions	(200)	(183)
Subtotal	224	241
Allocation of Loss Provision	(21)	(36)
Trust Certificates (Loan Guaranty)	\$ 203	\$ 205

6. ACCOUNTS RECEIVABLE, NET**Accounts Receivable, Net
as of September 30,**

	2002	2001
Intragovernmental Accounts Receivable	\$ 114	\$ 65
Public Accounts Receivable, Gross	\$ 2,567	\$ 2,604
Allowance for Loss Provision	(1,368)	(1,328)
Net Public Accounts Receivable	\$ 1,199	\$ 1,276

7. DIRECT LOANS AND LOAN GUARANTEES

Direct loan obligations and loan guarantee commitments made after 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990. The Act provides that the present value of the subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed. Direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimates will most likely require a future cash outflow to pay defaulted claims.

Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The recorded value of loans receivable, net, and the value of assets related to direct loans are not the same as the proceeds that VA would expect to receive from selling its loans. VA operates the following direct loan and loan guaranty programs:

- Vocational Rehabilitation and Employment;
- Education;
- Insurance; and
- Loan Guaranty

Under the Loan Guaranty Program, a loan may be made to an eligible veteran by an approved private sector mortgage lender. VA guarantees payment of a fixed percentage of the loan indebtedness to the holder of such a loan, up to a maximum dollar amount, in the event of default by the veteran borrower. When a delinquency is reported to VA and no realistic alternative to foreclosure is developed by the loan holder or VA supplemental servicing of the loan, VA determines, through an economic analysis, whether VA will authorize the holder to convey the property securing the loan (foreclosure) or pay the loan guarantee amount to the holder.

Direct Loans

Loans receivable related to direct loans represent the net value of assets related to pre-1992 and post-1991 direct loans acquired. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans). For post-1991 loans, the assets are offset by an allowance for subsidy costs. An analysis of loans receivable and the nature and amounts of the subsidy costs associated with the direct loans are provided in the tables that follow:

LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY FROM DIRECT LOANS AS OF SEPTEMBER 30,

2002	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	\$ 148	\$ 19	\$ -	\$ -	\$ 167
Direct Loans Obligated after 1991	1,619	48	853	64	2,584
Insurance Policy Loans	827	20	-	-	847
TOTAL LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY FROM DIRECT LOANS, NET					\$ 3,598

LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY FROM DIRECT LOANS AS OF SEPTEMBER 30,

2001	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	\$ 183	\$ 21	\$ -	\$ -	\$ 204
Direct Loans Obligated after 1991	1,783	44	1,044	32	2,903
Insurance Policy Loans	879	24	-	-	903
TOTAL LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY FROM DIRECT LOANS, NET					\$ 4,010

DIRECT LOANS DISBURSED

The total amount of direct loans disbursed for the years ended September 30, 2002 and 2001, was \$1,076 and \$1,489 million, respectively.

PROVISION FOR LOSSES ON PRE-1992 LOANS

One element of the cost of the mortgage loan benefit that VA provides to veterans is the present value of the cost VA will bear as loans already guaranteed default in the future. This cost is reflected in the financial statements as an offset to the value of certain related assets.

The provision for losses on vendee loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The calculation is also based on the use of the average interest rate of U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding guaranteed loans will default over a 12-year period. For FY 2002, VA determined that these vendee loans have sufficient equity due to real estate appreciation and buy-down of principal, to minimize or eliminate any potential loss to VA. The components of the provision are as follows:

PROVISION FOR LOSS AS OF SEPTEMBER 30,

	2002	2001
Offsets Against Foreclosed Property Held for Sale	8	8
Total Provision for Loss	\$ 8	\$ 8

SUBSIDY EXPENSE FOR POST-1991 DIRECT LOANS

Pursuant to the Credit Reform Act, all direct loans established after September 30, 1991, will be subsidized. The subsidy expense for direct loans is as shown:

DIRECT LOAN SUBSIDY EXPENSE FOR THE YEARS ENDED SEPTEMBER 30,

	2002	2001
Interest Differential	\$ (175)	\$ (445)
Defaults*	33	63
Fees**	(926)	(1,236)
Other***	1,077	1,650
Subtotal	9	32
Interest Rate Reestimates	181	(6)
Technical Reestimates	14	(691)
Total Direct Loans	\$ 204	\$ (665)

* Includes approximately \$58,000 and \$159,000 in defaults and other expenses for the Vocational Rehabilitation Program for FY 2002 and 2001 respectively.

** "Fee" expense for direct loans includes estimated down payments and other fees collected when homes are sold with vendee financing.

*** The "Other" expense for direct loans includes the estimated loss of scheduled principal and interest when vendee loans are sold.

SUBSIDY RATES FOR DIRECT LOANS BY COMPONENT

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

SUBSIDY RATES FOR DIRECT LOANS

Interest Differential	(16.45%)
Defaults	3.13%
Fees	(86.85%)
Other	101.03%

ALLOWANCE FOR SUBSIDY FOR DIRECT LOANS (Post-1991)

VA reports the allowance for subsidy for direct loans, subject to Credit Reform requirements. For these loans, the allowance for subsidy represents the present value of the estimated net cash flows to be paid by VA as a result of a disbursed direct loan. VA disburses a direct loan and receives an allowance for subsidy along with borrowing from Treasury. The FY 2002 and 2001 subsidy rate is 0.86 and 2.16 percent, respectively. The allowance for subsidy as of September 30, 2002 and 2001 is -\$853 and -\$1,044 million.

SCHEDULE FOR RECONCILING SUBSIDY COST ALLOWANCE BALANCES

Beginning Balance, Changes and Ending Balance	FY 2002	FY 2001
Beginning balance of the allowance	\$ (1,044)	\$ (61)
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(175)	(445)
Default costs (net of recoveries)	33	63
Fees and other collections	(926)	(1,236)
Other subsidy costs	1,077	1,650
Total of the above subsidy expense components	9	32
Adjustments:		
Loan modification	-	44
Fees received	18	27
Foreclosed property acquired	11	(26)
Loans written off	(7)	(3)
Subsidy allowance amortization	(35)	(9)
Other	-	2
Ending balance of the allowance before reestimates	(1,048)	6
Subsidy reestimates by component		
Interest rate reestimate	181	(352)
Technical/default reestimate	14	(698)
Total of the above reestimate components	195	(1,050)
Ending balance of the allowance	\$ (853)	\$ (1,044)

Loan Guarantees

Loans receivable related to loan guarantees represent the net value of assets related to pre-1992 and post-1991 defaulted guaranteed loans and non-defaulted guaranteed loans. For pre-1992 loans, VA employs the allowance for

loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans). An analysis of loans receivable, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy costs associated with loan guarantees are provided in the tables that follow:

LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY FROM LOAN GUARANTEES AS OF SEPTEMBER 30,

2002	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans Pre-1992 Guarantees	162	5	(150)	54	71
Defaulted Guaranteed Loans Post-1991	-	-	-	872	872
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					\$ 943

LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY FROM LOAN GUARANTEES AS OF SEPTEMBER 30,

2001	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Defaulted Guaranteed Loans Pre-1992 Guarantees	197	6	(181)	75	97
Defaulted Guaranteed Loans Post-1991	-	-	-	830	830
Total Loans Receivable and Related Foreclosed Property from Loan Guarantees					\$ 927

TOTAL LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY, NET FOR THE YEARS ENDED SEPTEMBER 30,

	2002	2001
Total Direct Loans	\$ 3,598	\$ 4,010
Total Guaranteed Loans	943	927
Total Loans Receivable and Related Foreclosed Property, Net	\$ 4,541	\$ 4,937

FORECLOSED PROPERTY

Prior to the foreclosure of property secured by a VA loan, VA obtains an independent appraisal of the property. This appraisal is reviewed by VA staff who make a determination of the fair market value. To determine the net value of the property, VA costs for acquisition, management and disposition of the property, as well as estimated losses on property resale, are subtracted from the estimated fair market value. As of September 30, 2002 and 2001, the estimated number of residential properties in VA's inventory was 11,981 and 14,543, respectively. For FY 2002 and FY 2001, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 8.7 months and 8 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 10,986 and 8,425 as of September 30, 2002 and 2001, respectively.

GUARANTEED LOANS AS OF SEPTEMBER 30,

	2002	2001
<u>Guaranteed Loans Outstanding:</u>		
Outstanding Principal Guaranteed Loans, Face Value	\$ 216,042	\$ 218,455
Amount of Outstanding Guarantee	69,547	71,431
<u>New Guaranteed Loans Disbursed:</u>		
Outstanding Principal Guaranteed Loans, Face Value	\$ 40,129	\$ 31,256
Amount of Outstanding Guarantee	11,667	9,154
Liabilities for Loan Guarantees Post 1991 (Present Value)	\$ 5,662	\$ 5,310

GUARANTY COMMITMENTS

As of September 30, 2002, VA had outstanding commitments to guarantee loans that will originate in FY 2003. The number and amount of commitments could not be determined, as VA has granted authority to various lenders to originate VA loans that meet established criteria without prior VA approval. Nearly 90 percent of VA's guaranteed loans originate under this authority.

SUBSIDY EXPENSE FOR POST-1991 LOAN GUARANTEES

Pursuant to the Credit Reform Act, guaranteed loans closed after September 30, 1991, will be subsidized. The subsidy expense for loan guarantees related to the Loan Guaranty Program is as shown:

GUARANTEED LOAN SUBSIDY EXPENSES FOR THE YEARS ENDED SEPTEMBER 30,

	2002	2001
Defaults	\$ 1,242	\$ 1,036
Fees*	(723)	(630)
Other**	(374)	(316)
Subtotal	145	90
Interest Rate Reestimates	(82)	3
Technical Reestimates	(88)	(172)
Total Guaranteed Loan Subsidy Expense	\$ (25)	\$ (79)

* The "Fee" expense includes estimated up-front fees collected when the loans are guaranteed and the present value of estimated annual fees from loan assumptions.

** The "Other" expense for guaranteed loans includes estimated recoveries on defaults through the sales of foreclosed properties.

LOAN SALE-GUARANTEED LOAN SUBSIDY EXPENSE FOR THE YEARS ENDED SEPTEMBER 30,

	2002	2001
Defaults	\$ 49	\$ 42
Other	-	-
Subtotal	49	42
Interest Rate Reestimates	(57)	-
Technical Reestimates	(96)	6
Total Loan Sale-Guaranteed Subsidy Expense	\$ (104)	\$ 48

TOTAL SUBSIDY EXPENSE FOR THE YEARS ENDED SEPTEMBER 30,

	2002	2001
Total Direct Loans	\$ 204	\$ (665)
Total Guaranteed Loans	(25)	(79)
Total Sale Loans	(104)	48
Total Subsidy Expense	\$ 75	\$ (696)

SUBSIDY RATES FOR LOAN GUARANTEES BY COMPONENT

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loan guarantees reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

SUBSIDY RATES FOR LOAN GUARANTEES

Defaults	3.35%
Fees	(1.95%)
Other	(-1.01%)

Loan Sales

VA continues to have vendee loan sales to reduce the administrative burden of servicing vendee loans. During the period FY 1992 through FY 2002, the total loans sold amounted to \$13.2 billion. Under the sale of vendee loans, certificates are issued pursuant to the Pooling and Servicing Agreement (the Agreement) among VA, the Master Servicer, and the Trustee. On the closing date of the certificates, VA transfers its entire interest in the related loans to the Trustee for the benefit

of the related certificate holders pursuant to the Agreement. Under the Agreement, the Trust will issue certificates backed by mortgage loans and installment contracts. The Trust owns the mortgage loans and other property described in the offering and the Trust makes elections to treat certain of its assets as one or more Real Estate Mortgage Investment Conduits (REMIC) for U.S. Federal income tax purposes. The certificates represent interests in the assets of the Trust and are paid from the Trust's assets. The certificates are issued as part of a designated series that may include one or

more classes. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates, and that guaranty is backed by the full faith and credit of the Federal Government.

VA may terminate the Trust, causing the early retirement of certificates, by purchasing all of the Trust's assets on any distribution date on or after the distribution date on which the current aggregate principal balance of all principal certificates is less than 1 percent of the original aggregate principal balance, or if VA determines that the Trust's REMIC status has been lost or a substantial risk exists that such status will be lost. In the event of termination, the certificate holder will be entitled to receive payment for the full principal balance of the certificates plus any accrued interest and unpaid interest through the related distribution date.

The Agreement requires the mortgage loans to be serviced generally in compliance with Fannie Mae and Freddie Mac standards and consistent with prudent residential mortgage loan servicing standards generally accepted in the servicing

industry. For mortgage loans sold during 2001 and 2002, servicing is/will be performed by Countrywide Home Loans, Inc. (formerly Countrywide Funding Corporation) ("CHL" or "Master Servicer"). The Master Servicer is responsible for the performance of all of the servicing functions under the Agreement. The Master Servicer is entitled to be compensated by receiving (1) a service fee of 0.2075 percent per annum payable monthly and calculated by multiplying the interest payment received by a fraction, the numerator of which is 0.2075 percent and the denominator of which is the mortgage interest rate on such loan; (2) earnings on investment of funds in the certificate account; and (3) all incidental fees and other charges paid by the borrowers and a portion of the liquidation proceeds in connection with the liquidated loans.

VA completed four sales during FY 2002 and two sales during FY 2001 totaling approximately \$970 million and \$811 million of vendee loans, respectively. The components of the vendee sales are summarized in the tables below:

LOAN SALES YEARS ENDED SEPTEMBER 30,

	2002	2001
Loans Receivable Sold	\$ 970	\$ 811
Net Proceeds From Sale	1,007	841
Loss (Gain) on Receivables Sold	\$ (37)	\$ (30)

OUTSTANDING BALANCE OF LOAN SALE GUARANTEES

All loans sold under the American Housing Trust (AHT VI through AHT XI) and the Vendee Mortgage (VMT 92-1 through 02-3) programs carry a full government guarantee. The outstanding balance for guaranteed loans sold is summarized in the table below:

GUARANTEED LOANS SOLD AS OF SEPTEMBER 30,

	2002	2001
Outstanding Balance Guaranteed Loans Sold, Start of Year	\$ 7,952	\$ 8,154
Sold to the Public	970	811
Payments, Repayments, and Terminations	(1,516)	(1,013)
Outstanding Balance Guaranteed Loans Sold, End of Year	\$ 7,406	\$ 7,952

LIABILITY FOR LOAN SALE GUARANTEES (POST-1991)

VA reports the liability on the guarantee of loans sold under the Vendee Mortgage Trust and American Housing Trust programs, subject to Credit Reform requirements. For these loans, the guaranteed loan sale liability represents the present value of the estimated net cash flows to be paid by VA as a result of the guarantee. These sales contain two types of guarantees for which VA pays net cash flow. VA guarantees that the principal and interest payment due on a loan sold will be paid by the 15th of each month. If not paid by the borrower, VA allows the loan servicer to take funds from cash reserve accounts for the deficient amount. VA also guarantees the loan against loss at foreclosure. VA will not buy back the loans but will pay off the loan loss and foreclosure expenses. The subsidy rate for FY 2002 and 2001 is 5.05 and 5.21 percent, respectively. The liability for loan sale guarantees as of September 30, 2002 and 2001 is \$210 and \$283 million.

SCHEDULE FOR RECONCILING LOAN SALE GUARANTEE LIABILITY BALANCES

Beginning Balance, Changes and Ending Balance	FY 2002	FY 2001
Beginning balance of the liability	\$ 283	\$ 215
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Interest subsidy costs	-	-
Default costs (net of recoveries)	49	42
Fees and other collections	-	-
Other subsidy costs	-	-
Total of the above subsidy expense components	49	42
Adjustments:		
Loan guarantee modifications	-	-
Fees received	-	-
Interest supplements paid	-	-
Foreclosed property and loans acquired	-	-
Claim payments to lenders	(21)	(36)
Interest accumulation on the liability balance	17	26
Other	35	30
Ending balance of the liability before reestimates	363	277
Subsidy reestimates by component		
Interest rate reestimate	(57)	-
Technical/default reestimate	(96)	6
Total of the above reestimate components	(153)	6
Ending balance of the liability	\$ 210	\$ 283

LIABILITY FOR LOAN GUARANTEES (POST-1991)

VA reports the liability on the guarantee of loans, subject to Credit Reform requirements. For these loans, the guaranteed loan liability represents the present value of the estimated net cash flows to be paid by VA as a result of a defaulted loan guarantee. VA guarantees the loan against loss at foreclosure for which VA pays net cash flow up to a legally specified maximum based on the value of individual loans. VA will pay the lender the guarantee and foreclosure expenses. If an agreement can be made with the veteran, VA may acquire the loan by refunding the lender for the loan. The FY 2002 and 2001 subsidy rate is 0.39 and 0.29 percent, respectively. The liability for loan guarantees as of September 30, 2002 and 2001 is \$5,452 and \$5,027 million.

SCHEDULE FOR RECONCILING LOAN GUARANTEE LIABILITY BALANCES

Beginning Balance, Changes and Ending Balance	FY 2002	FY 2001
Beginning balance of the liability	\$ 5,027	\$ 4,802
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Interest subsidy costs	-	-
Default costs (net of recoveries)	1,242	1,036
Fees and other collections	(723)	(630)
Other subsidy costs	(374)	(316)
Total of the above subsidy expense components	145	90
Adjustments:		
Loan guarantee modifications	-	72
Fees received	524	506
Interest supplements paid	-	-
Foreclosed property and loans acquired	230	(93)
Claim payments to lenders	(581)	(363)
Interest accumulation on the liability balance	277	283
Other	-	(57)
Ending balance of the liability before reestimates	5,622	5,240
Subsidy reestimates by component		
Interest rate reestimate	(82)	(44)
Technical/default reestimate	(88)	(169)
Total of the above reestimate components	(170)	(213)
Ending balance of the liability	\$ 5,452	\$ 5,027

ADMINISTRATIVE EXPENSE

Administrative expense on direct and guaranteed loans for the years ended September 30, 2002 and 2001, was \$165 and \$162 million, respectively.

8. INVENTORIES

INVENTORIES AS OF SEPTEMBER 30,

	2002	2001
Held for Current Sale	\$ 73	\$ 85
Other	9	9
Total Inventories	\$ 82	\$ 94

9. GENERAL PROPERTY, PLANT, AND EQUIPMENT

Depreciation and amortization expense totaled \$851 and \$858 million in FY 2002 and FY 2001, respectively.

GENERAL PROPERTY, PLANT, AND EQUIPMENT AS OF SEPTEMBER 30, 2002

	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	\$ 269	\$ (7)	\$ 262
Buildings	14,158	(6,178)	7,980
Equipment	2,938	(1,684)	1,254
Other	1,754	(966)	788
Work in Progress	744	-	744
Total Property, Plant, and Equipment	\$ 19,863	\$ (8,835)	\$ 11,028

GENERAL PROPERTY, PLANT, AND EQUIPMENT AS OF SEPTEMBER 30, 2001

	Cost	Accumulated Depreciation	Net Book Value
Land and Improvements	\$ 208	\$ (4)	\$ 204
Buildings	14,202	(6,044)	8,158
Equipment	3,871	(2,192)	1,679
Other	1,802	(994)	808
Work in Progress	828	-	828
Total Property, Plant, and Equipment	\$ 20,911	\$ (9,234)	\$ 11,677

10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

The total amount of VA liabilities not covered by budgetary resources was \$853.8 billion and \$696.3 billion as of September 30, 2002 and 2001, respectively. The following table contains the components of the balance sheet liability:

COMPONENTS OF UNFUNDED LIABILITIES AS OF SEPTEMBER 30,

	2002	2001
Workers' Compensation*	\$ 2,105	\$ 2,142
Annual Leave	1,042	994
Judgment Fund	625	438
Environmental and Disposal	271	260
Accounts Payable – Canceled Appropriations	4	3
Veterans Compensation and Burial	849,200	691,900
Insurance	549	534
Total	\$ 853,796	\$ 696,271

* The actuarial estimate for workers' compensation provided by DOL was computed using interest rates of 5.20 percent for FY 2002 and 5.21 percent for FY 2001.

11. FEDERAL EMPLOYEE AND VETERANS BENEFITS

FEDERAL EMPLOYEE BENEFITS

Imputed Expenses-Employee Benefits years ended September 30,

	2002	2001
Civil Service Retirement System	\$ 257	\$ 281
Federal Employees Health Benefits	576	499
Federal Employees Group Life Insurance	2	2
Total Imputed Expenses-Employee Benefits	\$ 835	\$ 782

VETERANS BENEFITS

Certain veterans who die or are disabled from military service-connected causes, as well as their dependents, receive compensation benefits. Also, veterans are provided with burial flags, headstones/markers, and grave liners for burial in a VA national cemetery or are provided a plot allowance for burial in a private cemetery. These benefits are provided in recognition of a veteran's military service and are recorded as a liability on the balance sheet.

FEDERAL EMPLOYEE AND VETERANS BENEFITS LIABILITIES AS OF SEPTEMBER 30,

	2002	2001
FECA	\$ 1,763	\$ 1,813
Compensation	845,800	689,100
Burial	3,400	2,800
Total Federal Employee and Veterans Benefits Liabilities	\$ 850,963	\$ 693,713

VA provides certain veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the veteran died or was disabled from nonservice-connected causes. The actuarial present value of the future liability for pension benefits is a non-exchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2002 and 2001 was \$91.6 and \$80.0 billion, respectively.

ASSUMPTIONS USED TO CALCULATE THE VETERANS BENEFITS LIABILITY

Several significant actuarial assumptions were used in the valuation of compensation, pension, and burial benefits to calculate the present value of the liability. A liability was recognized for

the projected benefit payments to: (1) those beneficiaries, including veterans and survivors, currently receiving benefit payments; (2) current veterans who will in the future become beneficiaries of the compensation and pension programs; and (3) a proportional share of those in active military service as of the valuation date who will become veterans in the future. Future benefits payments to survivors of those veterans in classes (1), (2), and (3) are also incorporated into the projection.

All future benefits were discounted. Discount rates were based on rates for securities issued by Treasury on September 30, 2002, ranging from 1.51 to 4.80 percent, and on September 28, 2001, ranging from 2.36 to 5.45 percent. Benefit payments were assumed to occur at the midpoint of the fiscal year.

All calculations were performed separately by attained age for the Compensation and Pension

programs, while the Burial liability was calculated on an aggregate basis.

Life expectancies of beneficiaries collecting benefits from the Compensation and Pension programs were based upon studies of mortality experience of those beneficiaries between 1994 and 2002. Life expectancies of veterans not yet collecting these benefits used in the calculation of the liability for future beneficiaries are based on mortality derived from the 1989-91 U.S. decennial census and beneficiary mortality experience. Applying mortality improvements at a rate of 1 percent per annum brought both sets of mortality rates forward. In addition, rates of benefit termination of beneficiaries due to reasons other than mortality are also reflected.

The amount of benefits by category and age were based on current amounts being paid and

future cost of living adjustments (COLAs) to determine the average benefits per veteran for each future time period. A COLA of 1.4 percent was assumed for FY 2003. For fiscal years after 2003, COLAs have been determined from OMB's estimates prepared in conjunction with the Administration's annual budget. Expected changes in benefits due to other reasons were also reflected.

Expected benefit payments have been explicitly modeled for the next 70 years. This period is roughly the same as that used by the Office of the Actuary of the Social Security Administration (75 years). However, unlike Social Security, estimates of expected benefit payments after this 70-year period were incorporated in the liability based on extrapolations reflecting expected aggregate experience by beneficiary category between the years 65 and 70.

12. ENVIRONMENTAL AND DISPOSAL

VA had unfunded environmental and disposal liabilities in the amount of \$271 million and \$260 million for the years ended September 30, 2002 and 2001, respectively. The majority of the unfunded liabilities involve asbestos removal, lead abatement, replacement of underground oil and gasoline tanks, decommissioning of waste incinerators, and decontamination of equipment prior to disposal.

While some facilities have applied prevailing state regulations that are more stringent than Federal

guidelines, the Occupational Safety and Health Administration and Environmental Protection Agency regulations are the legal base behind the majority of VA's environmental and disposal liabilities. Estimated liabilities for these projects are based on known contamination that exists today and have been computed by the facility engineering staff based on similar projects already completed, or by independent contractors providing work estimates.

13. OTHER LIABILITIES

Funded liabilities are generally considered to be current liabilities. Unfunded liabilities are generally considered to be non-current liabilities.

OTHER INTRAGOVERNMENTAL FUNDED LIABILITIES AS OF SEPTEMBER 30,

	2002	2001
Deposit and Clearing Account Liabilities	\$ (13)	\$ 15
Accrued Expenses - Federal	46	19
Deferred Revenue	234	81
Resources Payable to Treasury	467	593
Custodial Liabilities*	879	1,798
General Fund Receipts Liability	20	21
Accrued VA Contributions for Employee Benefits	41	32
Total Other Intragovernmental Funded Liabilities	\$ 1,674	\$ 2,559

* The Custodial Liabilities Accounts include subsidy reestimates for loans made after September 30, 1991, which are subject to the provisions of the Credit Reform Act of 1990. The liability provision for future losses on credit reform guaranteed loans is comprised of a funded subsidy for each loan guaranteed at the rate equal to the amount of the present value of estimated loss to the Government for the cohorts of loans. The subsidy amount for each cohort is reestimated annually to ensure amounts reflect the actual losses on guaranteed loans. Based on the reestimated amounts, additional subsidy funds are provided for or excess funds are returned.

OTHER INTRAGOVERNMENTAL UNFUNDED LIABILITIES AS OF SEPTEMBER 30,

	2002	2001
Accrued FECA Liability	\$ 342	\$ 330
Total Other Intragovernmental Unfunded Liabilities	\$ 342	\$ 330

OTHER PUBLIC FUNDED LIABILITIES AS OF SEPTEMBER 30,

	2002	2001
Accrued Funded Annual Leave	\$ 10	\$ 9
Accrued Expenses	1,988	1,924
Accrued Salaries and Benefits	292	350
Contract Holdbacks	17	19
Deferred Revenue	3	2
Unredeemed Coupons	1	1
Deposit and Clearing Account Liability	42	42
Unearned Premiums	124	131
Insurance Dividends Left on Deposit and Related Interest Payable*	1,636	1,577
Dividend Payable to Policyholders	279	301
Capital Lease Liability	27	27
Total Other Public Funded Liabilities	\$ 4,419	\$ 4,383

* Interest earned on dividends left on deposit is paid annually to insurance policyholders on the policy anniversary dates.

OTHER PUBLIC UNFUNDED LIABILITIES AS OF SEPTEMBER 30,

	2002	2001
Annual Leave*	\$ 1,042	\$ 994
Accounts Payable from Cancelled Appropriation	4	3
Judgment Fund-Unfunded**	625	438
Total Other Public Unfunded Liabilities	\$ 1,671	\$ 1,435

* Annual leave is accrued when earned and is adjusted at the end of the fiscal year to reflect current pay rates of cumulative leave earned but not taken. Sick and other types of leave are expensed as taken.

** The Judgment Fund liability amount represents the estimate for future payments on legal cases that will be paid by the Treasury Judgment Fund on behalf of VA.

14. LEASES

VA has both capital and operating leases. The capital lease liability is \$27 and \$27 million as of September 30, 2002 and 2001, respectively. Due to the number of operating leases and the decentralization of records, the future commitment for operating leases is not known. VA's FY 2002 operating lease costs were \$206 million for real property rentals and \$55 million for equipment rentals. The FY 2001 operating lease costs consisted of \$198 million for real property rentals and \$52 million for equipment rental. The following chart represents VA's estimate for operating lease costs for the next 5 years, assuming a range of 3.4 to 3.6 percent yearly increase in cost.

LEASES:

YEAR	PERCENTAGE	REAL PROPERTY	EQUIPMENT
2003	3.5	\$ 213	\$ 57
2004	3.4	221	59
2005	3.5	229	61
2006	3.6	238	63
2007	3.6	246	66

15. INSURANCE PROGRAMS

Through VA, the United States Government administers five life insurance programs and the Veterans' Mortgage Life Insurance program for certain totally disabled veterans. VA supervises the Servicemembers' Group Life Insurance (SGLI) and the Veterans' Group Life Insurance (VGLI) programs, which provide life insurance coverage to members of the uniformed armed services, reservists and post-Vietnam veterans. United State Code, Title 38, requires that the Life Insurance programs invest in Treasury securities.

ADMINISTERED PROGRAMS

The United States Government Life Insurance (USGLI) program was the Government's first venture into life insurance. During World War I, the U.S. provided Marine Insurance to protect the interests of ship owners and merchants who were providing supplies to the allies in Europe. USGLI was the natural outgrowth of this Marine Insurance. The program was established to meet the needs of World War I veterans, but remained open to servicemembers and veterans with service before October 8, 1940. The Government became a self-insurer because private insurance companies were unwilling to assume the unpredictable risks associated with war. By establishing this program, Congress intended to avoid the financial burden imposed on the Government by the pension programs that were established after previous wars. The Government became the largest life insurer in the United States with the coverage provided by this program.

The National Service Life Insurance (NSLI) program covers policyholders who served during World War II. The program opened October 8, 1940, when it became clear that large-scale military inductions were imminent. Over 22 million policies were issued under the NSLI program. The majority of policies VA administers directly are NSLI policies. This program remained open until April 25, 1951, when two new programs were established for Korean War servicemembers and veterans.

The Veterans' Special Life Insurance (VSLI) program was established in 1951 to meet the insurance needs of veterans who served during the Korean Conflict, and the post-Korean period through January 1, 1957. During this period, all servicemembers on active duty were covered for \$10,000, at no cost, under a program known as Servicemen's Indemnity. They remained covered for 120 days after their discharge. The VSLI program allowed these newly discharged servicemembers to apply for \$10,000 of contract term insurance. Application had to be made during the 120-day period during which they remained covered by Servicemen's Indemnity. It was during this period that representatives of the commercial insurance industry began a major lobbying effort to get the Government out of the insurance business because the programs were viewed as competition. As a result, the VSLI program was closed to new issues at the end of 1956, and coverage for individuals in the uniformed services was terminated. Approximately 800,000 VSLI policies were issued between 1951 and 1957.

In addition to VSLI coverage, which was provided to healthy veterans, the Insurance Act of 1951 also established the Service-Disabled Veterans Insurance (S-DVI) program for veterans with service-connected disabilities. S-DVI is open to veterans separated from the service on or after April 25, 1951, who receive a service-connected disability rating. New policies are still being issued under this program.

In 1964, Congress enacted legislation providing for a limited reopening of NSLI and VSLI, and the Veterans' Reopened Insurance (VRI) program was established. Beginning May 1, 1965, veterans who had been eligible to obtain insurance between October 8, 1940, and January 1, 1957, could once again apply for government life insurance. They had one year to apply for this "reopened" insurance, which was available *only* to disabled veterans. Approximately 228,000 VRI policies were issued. No term insurance policies were issued in this program.

The Veterans' Mortgage Life Insurance (VMLI) program began in 1971, and is designed to provide financial protection to cover eligible veterans' home mortgages in the event of death. VMLI is issued to those severely disabled veterans who have received grants for specially adapted housing from VA. These grants are issued to veterans whose movement is substantially impaired because of their disability. The maximum amount of VMLI allowed an eligible veteran is \$90,000. The insurance is payable if the veteran dies before the mortgage is paid off and is payable only to the mortgage lender.

SUPERVISED INSURANCE PROGRAMS

The Servicemembers' Group Life Insurance (SGLI) program was established in 1965 for Vietnam-era servicemembers. SGLI is supervised by VA and is administered by the Office of Servicemembers' Group Life Insurance (OSGLI) under terms of a group insurance contract. This program provides low-cost term insurance protection to servicemembers.

In 1974, the Veterans' Group Life Insurance (VGLI) program became available. VGLI, like SGLI, is supervised by VA, but is administered by the OSGLI. VGLI provides for the conversion of SGLI coverage to lifetime term insurance protection after a servicemember's separation from service.

PUBLIC INSURANCE CARRIERS

VA supervises the administration of the SGLI and VGLI programs. Prudential Insurance Company of America (Prudential) provides insurance coverage directly for the SGLI and VGLI programs. VA has entered into a group policy with Prudential whereby Prudential and its reinsurers provide servicemembers and veterans coverage in multiples of \$10,000 up to a maximum of \$250,000. The basic SGLI coverage is provided to those members on active duty in the Army, Navy, Air Force, Marine Corps, Coast Guard, commissioned members of the Public Health Service and the National Oceanic and Atmospheric Administration. The Ready Reserve is also insured by SGLI, and includes reservists and members of the National Guard who are assigned to a unit or position in which they may be required to perform active duty or active duty for training.

The VGLI coverage is comprised of separated and retired active duty members and reservists covered under Basic SGLI.

The Veterans' Opportunities Act of 2001 extended life insurance coverage to spouses and children of members insured under the SGLI program, effective November 1, 2001. For a spouse, up to \$100,000 of coverage can be purchased in increments of \$10,000, not to exceed the amount of the servicemember's coverage. Each dependent child of every active duty servicemember or reservist insured under SGLI is automatically insured for \$10,000 free of charge.

Premiums for the SGLI and VGLI programs are set by mutual agreement between VA and Prudential. SGLI premiums for active duty personnel and their spouses are deducted from the servicemember's pay by the Armed Services components through the Department of Defense (DoD). DoD, through the Defense Finance and Accounting Service (DFAS), remits collected premiums to VA, which are then transmitted to Prudential. Prudential records the premiums and maintains investments in their accounting records separate and independent from the VA reporting entity. VA monitors Prudential's insurance reserve balances to determine their adequacy and may increase or decrease the amounts retained by Prudential for contingency purposes. The reserves for the contingent liabilities are recorded in Prudential's accounting records and are not reflected in the VA reporting entity, because the risk of loss on these programs is assumed by Prudential and its reinsurers through the terms and conditions of the group policy.

Effective January 1, 1970, the Secretary of Veterans Affairs determines the costs that are traceable to the extra hazards of duty in the uniformed services, on the basis of the excess mortality incurred by members and former members of the uniformed armed services insured under SGLI, above what their mortality would have been under peacetime conditions. The Secretary is authorized to make adjustments regarding contributions from pay appropriations as may be indicated from actual experience.

RESERVE LIABILITIES

The insurance reserves for administered programs are reported as liabilities covered by budgetary resources, while part of the S-DVI and Veterans Insurance and Indemnities reserves are reported as liabilities not covered by budgetary resources. Reserves for SGLI and VGLI are maintained in Prudential's financial records since the risk of loss is assumed by Prudential. Actuarial reserve

liabilities for the administered life insurance programs are based on the mortality and interest assumptions at time of issue. These assumptions vary by fund, type of policy and type of benefit. The interest assumptions range from 2.25 to 5.0 percent. The mortality assumptions include the American Experience Table, the 1941 Commissioners Standard Ordinary (CSO) Table, 1958 CSO Basic Table and the 1980 CSO Basic Table.

INSURANCE LIABILITY (RESERVE) BALANCES

INSURANCE LIABILITY RESERVE BALANCES As of SEPTEMBER 30, 2002

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	\$9,878	\$201	\$192	\$10,271
USGLI	38	6	-	44
VSLI	1,466	12	36	1,514
S-DVI	399	2	132	533
VRI	410	2	7	419
VI&I	89	-	-	89
Subtotal	\$12,280	\$223	\$367	\$12,870
Less Liability not Covered by Budgetary Resources				(549)
Liability Covered by Budgetary Resources				\$12,321

INSURANCE LIABILITY RESERVE BALANCES As of SEPTEMBER 30, 2001

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	\$10,049	\$219	\$220	\$10,488
USGLI	43	6	-	49
VSLI	1,429	13	39	1,481
S-DVI	397	2	121	520
VRI	423	3	8	434
VI&I	92	-	-	92

Subtotal	\$12,433	\$243	\$388	\$13,064
Less Liability not Covered by Budgetary Resources				(534)
Liability Covered by Budgetary Resources				\$12,530

INSURANCE IN-FORCE

The amount of insurance in-force is the total face amount of life insurance coverage provided by each administered and supervised program as of the end of the fiscal year. It includes any paid-up additional coverage provided under these policies. Prudential and its reinsurers provided coverage to 5,910,381 and 2,788,449 insured for a face value of \$728.3 billion and \$619.9 billion as of September 30, 2002 and 2001, respectively. This large increase in

number of participants and face value was the result of legislation which extended insurance coverage to the spouses and children of members insured under the SGLI program effective November 1, 2001. The face value of the insurance provided by Prudential and its reinsurers represents 97.3 and 96.7 percent of the total insurance in-force as of September 30, 2002 and 2001, respectively. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2002 POLICIES	2001 POLICIES	2002 FACE VALUE	2001 FACE VALUE
SUPERVISED PROGRAMS				
SGLI Active Duty	1,510,000	1,469,000	\$365,285	\$361,754
SGLI Ready Reservists	799,500	826,500	180,826	195,590
SGLI Post Separation	97,000	104,000	23,016	25,397
SGLI Family - Spouse	1,013,000	-	99,578	-
SGLI Family - Children	2,100,000	-	21,000	-
VGLI	390,881	388,949	38,563	37,145
Total Supervised	5,910,381	2,788,449	\$728,268	\$619,886
ADMINISTERED PROGRAMS				
NSLI	1,502,463	1,606,590	\$15,550	\$16,288
VSLI	227,341	233,335	2,604	2,635
S-DVI	148,913	148,674	1,414	1,401
VRI	67,531	72,581	587	618
USGLI	13,217	14,683	42	48
VMLI	3,060	3,300	186	193
Total Administered	1,962,525	2,079,163	\$20,383	\$21,183
Total Supervised and Administered Programs	7,872,906	4,867,612	\$748,651	\$641,069

POLICY DIVIDENDS

The Secretary of VA determines annually the excess funds available for dividend payment. Dividends are based on an actuarial analysis of the individual programs at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. Policyholders can elect to: (1) receive a cash payment; (2) prepay premiums; (3) repay loans; (4) purchase paid-up insurance or (5) deposit the amount in an interest-bearing account. A provision for dividends is charged to operations, and an insurance dividend is established when gains to operations are realized in excess of those essential to maintain solvency of the insurance programs. Policy dividends for fiscal years 2002 and 2001 were \$604 and \$646 million, respectively.

PRUDENTIAL INSURANCE COMPANY DEMUTUALIZATION

On December 18, 2001, Prudential completed its conversion from a mutual company to a stock company. As policyholder of the SGLI and VGLI programs, VA received 369,177 shares of Prudential stock. Prudential has stated that there will be no effect on the SGLI or VGLI programs as demutualization will not adversely change premiums or other Prudential obligations under the SGLI contract. VA intends to liquidate its holdings of Prudential stock and deposit the proceeds into the SGLI Contingency Reserve, which is held for VA by Prudential in an interest-bearing account. This will in effect guarantee that the monies are used for the benefit of the servicemembers and veterans who are the intended recipients of these life insurance benefit programs.

16. CONTINGENCIES

VA is a party in various administrative proceedings, legal actions, and tort claims arising from various sources including: disputes with contractors, challenges to compensation and education award decisions, loan guaranty indemnity debt cases, and allegations of medical malpractice. Certain legal matters to which VA may be a named party are administered and, in some instances, litigated by the Department of Justice. Generally, amounts (more than \$2,500 for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award are funded from the Judgment Fund, which is maintained by Treasury. Of the amounts paid from the Judgment Fund, malpractice cases claimed 77 percent in FY 2002 and 79 percent in FY 2001. Contract dispute

payments for FY 2002 and FY 2001 were \$11.0 and \$6.2 million, respectively.

VA has recorded a liability for pending legal claims that are estimated to be paid by the Judgment Fund. This liability is established for all pending claims whether reimbursement is required or not. This liability was \$625 million for FY 2002 and \$438 million for FY 2001. There were 21 contract and personnel law cases with claimed amounts totaling \$275 million where there was at least a reasonable possibility that a loss may occur. VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements. Judgment Fund accounting is shown below:

JUDGMENT FUND YEARS ENDED SEPTEMBER 30,

	2002	2001
Fiscal Year Settlement Payments	\$ 101	\$ 86
Less Contract Dispute Payments	(11)	(6)
Imputed Financing-Paid by Other Entities	90	80
Increase (Decrease) in Liability for Claims	187	23
Operating Expense	\$ 277	\$ 103

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2002 will not materially affect VA's operations or financial position when consideration is given to the availability of the Judgment Fund appropriation to pay some court-settled legal cases. Fiscal year 2002 settlement payments were \$101 million.

The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2002 and 2001 was \$111.3 million and \$144.9 million, respectively. Any payments due that may arise relating to cancelled appropriations will be paid out of the current year's appropriations in accordance with the provisions of the Expired Funds Control Act of 1990.

17. EXCHANGE TRANSACTIONS

EXCHANGE REVENUES

VHA has legislated exceptions to the requirement to recover the full cost to the Federal Government of providing services, resources, or goods for sale. Under "enhanced sharing authority," VHA facilities may enter into arrangements that are in the best interest of the Federal Government. In FY 2002, randomly selected VA medical centers were reviewed by the Financial and Systems Quality Assurance Service to determine the facility's compliance with Statement of Federal Financial Accounting Standards No. 7 and the Chief Financial Officers Act of 1990.

VA's Loan Guaranty Program collects rental fees on a small number of properties during the period when the property is titled to VA.

NCA leases lodges at 11 cemeteries to not-for-profit groups for no fee. The not-for-profit groups are required to provide the upkeep on the lodges and pay the costs for utilities, insurance, minor repairs and maintenance and any other costs associated with the lodges, and NCA pays for major repairs at these facilities. NCA also has four agricultural leases with private companies/individuals. NCA leases land for growing crops and, on certain leases, receives various services in exchange from the lessee, such as brush cutting and removal services, backfilling and grading of roads, and welding services. In addition, NCA received fees for motion picture filming performed at three cemeteries.

EXCHANGE TRANSACTIONS WITH PUBLIC

Exchange transactions with the public occur when prices are set by law or executive order and are not based on full cost or on market price. VA's Medical Care Collections Fund, "Conforming Amendments," changed the language of specific sections of 38 USC Chapter 17 to substitute "reasonable charges" for "reasonable cost." The VHA Chief Financial Officer (CFO) is responsible for implementing and maintaining these reasonable charges for billing third-party payers for services provided to insured veterans for treatment of nonservice-connected conditions.

Reasonable charges are used to bill for reimbursable health insurance, non-Federal workers' compensation and no-fault or uninsured motorists insurance cases. Reasonable charges are based on provider charges in the market area of each VA facility. The lesser of VA-billed charges or their usual customary and reasonable payment to other providers will be paid.

Cost-based per diems are calculated annually to produce tort rates used to bill for tortfeasor, workers' compensation (other than Federal), humanitarian emergency, ineligible patient, VA employee, family member, allied beneficiary, no fault or uninsured motorist's insurance, or reimbursable insurance cases. These per diem costs are derived primarily from cost and workload data from a national cost allocation report (Cost Distribution Report).

VA is required to collect a co-payment of \$7 from veterans for treatment of a nonservice-connected condition for each 30-day supply of medication furnished on an outpatient basis. This fee does not cover the cost of the medications in the vast majority of cases.

VA's Loan Guaranty Program collects certain fees that are set by law. The loan guarantee funding fees collected for FY 2002 were \$523 million and for FY 2001 were \$526 million. The loan guarantee lender participation fees collected for FY 2002 were \$1.6 million and for FY 2001 were \$1.7 million.

INTRAGOVERNMENTAL EXCHANGE TRANSACTIONS

This section discloses intragovernmental exchange transactions in which VA provides goods or services at a price less than the full cost, or does not charge a price at all, with explanations for disparities between the billing and full cost.

VA and DoD have authority to enter into agreements and contracts for the mutual use or exchange of use of hospital and domiciliary facilities and other resources. The providing agency

shall be reimbursed for the cost of the health care resources based on the methodology agreed to by VA and DoD. Facility directors have the flexibility to consider local conditions and needs and the actual costs of providing the services. VA's General Counsel has determined that full cost recovery is not mandated. VHA captures the total amount of reimbursements received under DoD sharing agreements, but the total amount billed below full cost is not readily available. VHA is in the process of developing mechanisms to report this information in the future. VBA collects funding from DoD in order to administer certain education programs. DoD transferred \$251.7 million during the year for the Post-Vietnam Era Education Assistance Program, Reinstated Entitlements Program for Survivors and the New GI Bill for Veterans.

When VA furnishes medical care or services for beneficiaries of other Federal agencies, and that care or service is not covered by an applicable local sharing agreement, the billing rates used are determined and published annually by the VHA CFO. Similar to the tort rates, interagency billing rates are determined from cost and workload data in the Cost Distribution Report.

18. NET COST OF VETERANS AFFAIRS PROGRAMS

All of VA's net program costs are part of the 700 budget functional classification (Veterans Benefits and Services).

SCHEDULE OF NET PROGRAM COST

Year Ended September 30, 2002 (Dollars in Millions)	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehab	Loan Guaranty	Insurance	Burial	Non-Program	Total
Production Costs												
Intragovernmental Costs	\$ 2,898	\$ 26	\$ 62	\$ 120	\$ 8	\$ 7	\$ 5	\$ 432	\$ 6	\$ 51	\$ 63	\$ 3,678
Less Earned Revenues	(43)	-	(8)	-	(10)	(235)	-	(563)	(995)	-	(637)	(2,491)
Net Intragovernmental Production Costs	2,855	26	54	120	(2)	(228)	5	(131)	(989)	51	(574)	1,187
Public Costs	20,524	993	771	179,473	3,227	1,781	499	438	1,746	951	1,289	211,692
Less Earned Revenues	(1,427)	-	(18)	-	-	(236)	-	(147)	(691)	-	(56)	(2,575)
Net Public Production Costs	19,097	993	753	179,473	3,227	1,545	499	291	1,055	951	1,233	209,117
Non-Production Costs												
Hazardous Waste Clean-up	11	-	-	-	-	-	-	-	-	-	-	11
Total Net Cost of Operations	\$ 21,963	\$ 1,019	\$ 807	\$ 179,593	\$ 3,225	\$ 1,317	\$ 504	\$ 160	\$ 66	\$ 1,002	\$ 659	\$ 210,315

SCHEDULE OF NET PROGRAM COST

Year Ended September 30, 2001 (Dollars in Millions)	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehab	Loan Guaranty	Insurance	Burial	Non-Program	Total
Production Costs												
Intragovernmental Costs	\$ 3,310	\$ 111	\$ 108	\$ 150	\$ 53	\$ 18	\$ 35	\$ 290	\$ 10	\$ 31	\$ 28	\$ 4,144
Less Earned Revenues	(48)	-	(17)	-	(13)	(214)	-	(883)	(1,025)	-	(415)	(2,615)
Net Intragovernmental Production Costs	3,262	111	91	150	40	(196)	35	(593)	(1,015)	31	(387)	1,529
Public Costs	18,338	666	648	160,049	3,194	1,511	508	455	1,788	227	956	188,340
Less Earned Revenues	(1,522)	-	(10)	-	-	(289)	-	(94)	(719)	-	(27)	(2,661)
Net Public Production Costs	16,816	666	638	160,049	3,194	1,222	508	361	1,069	227	929	185,679
Non-Production Costs												
Hazardous Waste Clean-up	51	1	1	-	-	-	-	-	-	-	-	53
Total Net Cost of Operations	\$ 20,129	\$ 778	\$ 730	\$ 160,199	\$ 3,234	\$ 1,026	\$ 543	\$ (232)	\$ 54	\$ 258	\$ 542	\$ 187,261

19. DISCLOSURES RELATED TO THE STATEMENTS OF BUDGETARY RESOURCES

APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

OBLIGATIONS YEARS ENDED SEPTEMBER 30,

	2002	2001
Category A, Direct	\$ 26,452	\$ 23,637
Category B, Direct	33,491	31,628
Reimbursable	3,303	2,422
Exempt from Apportionment	1,736	1,775
Total Obligations	\$ 64,982	\$ 59,462

BORROWING AUTHORITY

Loan Guaranty had borrowing authority of \$3.8 billion and \$1.7 billion as of September 30, 2002, and 2001, respectively. The Vocational Rehabilitation Program had borrowing authority of \$2.8 and \$1.8 million as of September 30, 2002 and 2001, for making direct loans. Loan Guaranty borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to Vinnie MAC trusts. The Vocational Rehabilitation loans generally had duration of 1 year, and repayment was made from offsetting collections.

ADJUSTMENTS TO BUDGETARY RESOURCES

During the reporting period, adjustments to budgetary resources available at the beginning of the year included VA appropriations that were subjected to a rescission that totaled \$17.6 million. Various VA program accounts received a cut in discretionary budget authority.

PERMANENT INDEFINITE APPROPRIATIONS

VA has three permanent and indefinite appropriations. The Veterans Housing Benefit Program Fund covers all estimated subsidy costs arising from post-1991 loan obligations for veterans housing benefits. The Fund's objective is to encourage and facilitate the extension of favorable credit terms by private lenders to veterans for the purchase, construction, or improvement of homes to be occupied by veterans and their families. The Loan Guarantee Revolving Fund is a liquidating account that contains all of VA's pre-credit reform direct and guaranteed loans. It also holds fund balances received from reimbursements from financing accounts for loan modifications and rentals of foreclosed properties not yet transferred to financing accounts. The Native American Direct Loan Account was established to cover all subsidy costs arising from direct loan obligations related to a veteran's purchase, construction, or renovation of a dwelling on trust land.

USE OF UNOBLIGATED BALANCES OF BUDGET AUTHORITY

Available unobligated balances on the Statement of Budgetary Resources are composed of current fiscal year apportioned funds for annual, multi-year, and no-year appropriations from Congress as well as revolving and trust funds. Other balances not available are composed of expired appropriation unobligated amounts, which generally are not available for new obligations, but can be used to increase existing obligations under certain circumstances. This amount also includes unobligated funds that were not apportioned by OMB for FY 2002 use.

Unobligated VA funds are available for uses defined in VA's FY 2002 Appropriation Law (P.L. 107-74). These purposes include: veterans medical care, research, education, construction and maintenance of VA buildings, veterans and dependents benefits, veterans life insurance, loan guaranty programs, veterans burial benefits, and administrative functions. Various obligation limitations are imposed on individual VA appropriations. Examples include travel obligation limitations and limitation of the use of medical care multi-year funds to object classes for equipment, structures, and land.

EXPLANATION OF DIFFERENCES BETWEEN STATEMENT OF BUDGETARY RESOURCES AND THE BUDGET

As a result of an analysis of aged obligations, obligations were reduced by \$100 million and \$120 million on the Statements of Budgetary Resources for FY 2002 and 2001, respectively. These adjustments were not reflected in the FACTS II data used to prepare the President's Budget. No other differences were identified as of the preparation date of the financial statements.

CONTRIBUTED CAPITAL

The amount of contributed capital received during the fiscal year consisted of donations in the amount of \$47 million to the General Post Fund and \$0.2 million to the National Cemetery Gift Fund.

20. DISCLOSURES RELATED TO THE STATEMENTS OF FINANCING

The Statement of Financing section “Costs That Do Not Require Resources in the Current Period” includes only the fiscal year increases in liabilities not covered by budgetary resources. For existing liabilities, there will always be a difference

between this section and the value of liabilities not covered by budgetary resources disclosed in Note 10 and included in the liabilities section of the Balance Sheet.

21. DEDICATED COLLECTIONS

In the Federal Government, dedicated collections are accounted for in trust funds and special funds. The term “trust funds” as used in this report and in Federal budget accounting is frequently misunderstood. In the private sector, “trust” refers to funds of one party held by a second party (the trustee) in a fiduciary capacity. In the Federal budget, the term “trust fund” means only that the law requires that funds be accounted for separately, used only for specified purposes and that the account be designated as a “trust fund.”

A change in law may change the future receipts and the terms under which the fund’s resources are spent. The “trust fund assets” represent all sources of receipts and amounts due the trust fund regardless of source. This includes “related governmental transactions,” which are transactions between two different entities within the Federal Government. The “Investments with Treasury”

assets are comprised of investments in Federal debt securities and related accrued interest. These securities will require redemption if a fund’s disbursements exceed its receipts. Unless specifically provided for by law, trust funds may only place excess funds in Federally backed investments (e.g., Federal debt securities).

The table below summarizes the name, type, and purpose of the funds within VA that receive dedicated collections. All of the funds listed use the accrual basis of accounting. However, collections are reported as actually received in accordance with OMB Circular A-34. The insurance funds listed also adhere to the requirements of FASB No. 120, “Accounting and Reporting by Mutual Life Insurance Enterprise,” and issue a separate annual report. All of the funds generally receive authority to use current year contributions as well as a portion of previously contributed amounts.

FUND NAME	FUND TYPE	TREASURY SYMBOL	AUTHORITY	PURPOSE OF FUND	FINANCING SOURCES
Medical Care Collections Fund	Special	36x5287	P.L. 105-33 111 Stat 665	Accumulates recoveries from third parties and patient co-payments.	Public, primarily insurance carriers.
Health Service Improvement Fund	Special	36x5358	P.L. 106-117 113 Stat 1561	Accumulates recoveries from enhanced use leases and patient co-payments.	Public.
Escrowed Funds for Shared Medical Equipment Purchases	Deposit	36x6019	106 STAT. 1974	Receives payments from public companies involved in joint purchases of medical equipment.	Public, universities, pharmaceuticals & other medical organizations.
Personal Funds of Patients	Deposit	36x6020	38 U.S.C. 3204	Temporarily holds funds.	Public, patients.
Employee Allotments for Savings Bonds	Deposit	36x6050	31 U.S.C. 3105	Temporarily holds funds.	Employees.
Cemetery Gift Fund	Trust	36x8129	38 U.S.C. 1007	Receives donations for veteran cemeteries.	Public donors.
National Service Life Insurance Fund	Trust	36x8132	38 U.S.C. 720	Accumulates premiums to insure veterans of WWII.	Public, veterans.
Post-Vietnam Era Education Assistance Program	Trust	36x8133	38 U.S.C. 1622	Subsidizes the cost of education to veterans.	Veterans, DoD.
U.S. Government Life Insurance	Trust	36x8150	38 U.S.C. 755	Premiums insure WWI veterans.	Public, veterans.
Veterans Special Life Insurance Fund	Trust	36x8455	38 U.S.C. 723 101-228	Premiums insure Korean conflict veterans without Service-related disabilities.	Public, veterans.
General Post Fund, National Homes	Trust	36x8180	38 U.S.C. 101-228	Receives restricted and unrestricted use donations.	Public, mostly veterans.

Consolidated Financial Statements

The following tables provide condensed information on assets, liabilities, fund balances, net costs, and changes in fund balances:

As of SEPTEMBER 30, 2002

FUND SYMBOL

Assets:

Fund balance with Treasury

Investments with Treasury

Other Assets

Total Assets

Liabilities:

Payables to Beneficiaries

Other Liabilities

Total Liabilities

Net Position:

Cumulative Results

Total Liabilities & Net Position

	5287	5358	6020	8132	8133	8150	8455	8180	Total
Fund balance with Treasury	\$ 77	\$ 29	\$ 41	\$ 8	\$ 81	\$ -	\$ 1	\$ 17	\$ 254
Investments with Treasury	-	-	-	11,663	-	62	1,843	48	13,616
Other Assets	833	75	-	647	1	3	115	17	1,691
Total Assets	910	104	41	12,318	82	65	1,959	82	15,561
Liabilities:									
Payables to Beneficiaries	-	-	-	130	2	2	9	1	144
Other Liabilities	-	-	41	11,861	-	61	1,880	2	13,845
Total Liabilities	-	-	41	11,991	2	63	1,889	3	13,989
Net Position:									
Cumulative Results	910	104	-	327	80	2	70	79	1,572
Total Liabilities & Net Position	\$ 910	\$ 104	\$ 41	\$ 12,318	\$ 82	\$ 65	\$ 1,959	\$ 82	\$ 15,561

FOR THE YEAR ENDED SEPTEMBER 30, 2002

FUND SYMBOL

Revenues:

Exchange - Federal

Exchange - Public

Non-Exchange - Federal

Non-Exchange - Public

Total Revenues

Expenses:

Program Expenses

Total Expenses

Net Change from Operations

Beginning Net Position

Total Financing Sources

Change in Accounting Policy

Net Cost of Operations

Ending Equity

	5287	5358	8132	8133	8150	8455	8180	Total
Exchange - Federal	\$ (14)	\$ -	\$ 813	\$ -	\$ 4	\$ 143	\$ -	\$ 946
Exchange - Public	806	272	559	2	-	77	1	1,717
Non-Exchange - Federal	-	-	-	-	-	-	-	-
Non-Exchange - Public	-	-	-	-	-	-	-	-
Total Revenues	792	272	1,372	2	4	220	1	2,663
Expenses:								
Program Expenses	-	6	1,402	9	5	225	44	1,691
Total Expenses	-	6	1,402	9	5	225	44	1,691
Net Change from Operations								
Beginning Net Position	1,089	-	356	87	3	75	79	1,689
Total Financing Sources	(971)	(162)	1	-	-	-	49	(1,083)
Change in Accounting Policy	-	-	-	-	-	-	(6)	(6)
Net Cost of Operations	792	266	(30)	(7)	(1)	(5)	(43)	972
Ending Equity	\$ 910	\$ 104	\$ 327	\$ 80	\$ 2	\$ 70	\$ 79	\$ 1,572

22. RECLASSIFICATIONS, CHANGES IN ACCOUNTING POLICY AND CHANGES IN FINANCIAL STATEMENT PRESENTATION

RECLASSIFICATIONS

FY 2001 unobligated balances for the Loan Guaranty Financing Accounts were presented on the Statement of Budgetary Resources as available balances. These balances were submitted as unavailable balances in the Treasury FACTS II submission used for the President's Budget. The FY 2001 Statement of Budgetary Resources has been restated to reclassify unobligated balances totaling \$4.7 billion from the unobligated available line to the unobligated unavailable line.

CHANGES IN ACCOUNTING POLICY

The capitalization threshold for VA's fixed assets was raised from \$25,000 to \$100,000 during FY 2002. The reduction in real and personal property book value of \$618 million is presented on the Statement of Changes in Net Position line titled "Cumulative Effect of Change in Accounting Policy."

CHANGES IN FINANCIAL STATEMENT PRESENTATION

The Office of Management and Budget issued OMB Bulletin 01-09, Form and Content of Agency Financial Statements that superseded OMB Bulletin 97-01. Bulletin 01-09 changes

included revisions in some of the titles of basic financial statements as well as several changes in the presentation in the financial statements and related footnotes. In the Statement of Net Position, components of Net Position are separately displayed in two columns for Cumulative Results of Operations and Unexpended Appropriations to more clearly identify the components of Net Position. In the Statement of Budgetary Resources, Non-budgetary credit financing accounts are displayed in a separate column to more clearly distinguish between budgetary and non-budgetary activity to enhance linkage to the Budget of the United States Government. In the Statement of Financing, the "Combined Statement of Financing" title is replaced by the "Consolidated Statement of Financing" title.

In the Notes to the Consolidated Financial Statements, the Fund Balance with Treasury footnote disclosure is modified to include an additional breakout showing obligated amounts, available and unavailable amounts. Footnote 7 Direct Loans and Loan Guarantees is updated to conform to Statement of Federal Financial Accounting Standards (SFFAS) No. 18, Amendments to Accounting Standards for Direct Loans and Loan Guarantees.